

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

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77-7115 ORIGINAL

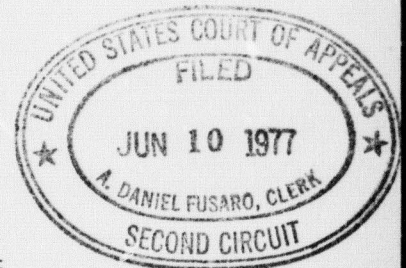
United States Court of Appeals
For the Second Circuit

CANDACE VAN ALLEN,
Plaintiff-Appellant-Appellee

—against—

DOMINICK & DOMINICK, INCORPORATED and
PAUL deGIVE,
Defendants-Appellees-Appellants

On Appeal from the United States District Court,
Southern District of New York



REPLY BRIEF FOR PLAINTIFF-APPELLANT-APPELLEE

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POINT I

IT IS UNDISPUTED THAT DOMINICK
WAS INFORMED OF THE NATURE OF
MR. KAMERMAN'S INQUIRY

Both Dominick and deGive are defendants in this lawsuit. Although it was ultimately decided by the plaintiff to include deGive as a defendant, plaintiff's initial inquiry was directed toward the trading practices of the firm of Dominick. It is important to note this fact which the defendants have conveniently ignored, and have never denied. Mr. Kamerman presented his inquiry with respect to the Van Alen account to Thomas F. Carey, Assistant Compliance Director of defendant Dominick. deGive came to Mr. Kamerman's office at Mr. Carey's request and for Dominick's benefit to answer questions which arose as to the handling of the Van Alen accounts. deGive presented himself as an employee of Dominick, a Vice President no less. Based on all of the past communications previously cited in plaintiff's brief (P. 10-11), including telephone conversations with deGive, and deGive's executive position with Dominick, Mr. Kamerman had every right to believe that deGive had been informed of the nature of the inquiry. Neither the law nor the canon of ethics require attorneys to do a useless act. Restating your capacity to one whom

you believe to be well aware of it is a very useless act and not required by any practice or code of conduct known to the plaintiff's attorneys. Thus, the ABA informal opinion No. 908 cited in Addendum J in defendants' brief completely supports Mr. Kamerman's conduct, for it is stated therein that there is nothing "unethical in the attorney for a potential plaintiff interviewing the potential defendant and taking his statement" provided the potential defendant is advised of the attorney's position. Here, the potential defendant, Dominick, was fully advised by undisputed correspondence to Carey. Even if the Court believed that the diaries could not be used against deGive, no reason is stated for not allowing the diaries as evidence against Dominick.

Moreover, defendants dismissed the cases cited in plaintiff's brief as not being applicable because some pertain to illegal searches and seizures. Clearly, the defendants missed the point. If the courts refused to exclude evidence in civil cases which is clearly tainted by a violation of a fundamental and precious right granted by the Constitution, surely the diaries in this case should not be excluded, even assuming arguendo that deGive was "tricked" into handing over the diaries and "lying" to Mr. Kamerman.

Defendants have never stated that deGive did not

know who Mr. Kamerman was and the nature of his inquiry. Their only complaint seems to be that Mr. Kamerman did not disclose his capacity to deGive. It is, therefore, quite apparent that defendants' cry of unethical conduct is only a ruse to prevent the introduction of evidence that would have been quite damaging to their case.

Defendants second attempt to justify the trial court's arbitrary exclusion of the deGive diaries is predicated on an unfounded conclusion drawn by defendants' counsel. Contrary to the erroneous statement made in defendants' brief (D. 41), all the parties do not recognize that deGive would testify that he had never misrepresented the diaries. Considering past inconsistencies, speculation as to deGive's testimony is useless. However, it is certain that deGive could not make the statement which his counsel, Jeffrey Barist, made to the court opposing the introduction of the diaries:

"So what if Mr. deGive says, as I expect him to say, as he has testified before, 'No, I never made any false representation to Mr. Kamerman,' then what?" (A. 584)

This quote is erroneously cited in defendants' brief as representing an agreement by the parties that deGive would deny making false representations to Mr. Kamerman, but a witness cannot answer in conclusory terms. The question to

deGive would center on how it came about that meetings which admittedly never took place came to be recorded on previously used and otherwise legitimate business records, i.e., deGive's daily diary.

More specifically, if deGive was willing to testify that he sifted through his old business records to find pages of his diaries that match the dates on which he at one time claimed to have had conversations with Van Alen, and that he jotted down a memorandum of those meetings on those pages just prior to coming to Mr. Kamerman's office for the sole purpose of "jogging his memory" when talking to Mr. Kamerman and not to present them to him as contemporaneous evidence of the meeting, plaintiff was willing to let the matter rest there. The trial court could evaluate this preposterous story when judging deGive's credibility, and thereby draw some conclusion as to his trustworthiness. Assuming that plaintiff wished to call Mr. Kamerman as a witness to recount deGive's prior inconsistent statements, and assuming that the canon of ethics was no bar to Mr. Kamerman's testimony, the trial court at that time could have determined that Mr. Kamerman's testimony was not necessary or was collateral to the issues. The inquiry could have ended at that point after all the evidence was presented and available for consideration.

In sum, by denying the voir dire, the trial court

did not know what deGive's testimony would be or what collateral issues might arise and blindly foreclosed plaintiff from introducing an essential piece of evidence. Thus, the trial court committed reversible error which not only affects the issue of scienter but affects all the issues which are in dispute, and in which there is conflicting testimony between the plaintiff and deGive.

POINT II

THE TRIAL COURT WAS IN ERROR WHEN IT DISMISSED COUNT V OF THE COMPLAINT

In their answering brief, defendants attempt to justify the dismissal of Count V of the complaint. Plaintiff will now show that Count V does state a good cause of action under the Federal Securities Laws and under the common law. In addition, plaintiff submits that, contrary to defendants' arguments, plaintiff was not given an adequate opportunity to prove at the trial that its damages were caused by Dominick's deliberate failure to follow the NYSE rules.

A. A Failure to Follow Rules 405 and 408 gives Rise to a Cause of Action under the Federal Securities Laws.

Defendants recognize in their answering briefs that Judge Friendly in the case of Colonial Realty Corp. v. Bache & Co., 358 F. 2d 178 (2d Cir.), cert. denied, 385 U.S. 817 (1966) held that a violation of stock exchange rules can give rise to an implied cause of action under the Federal Securities Laws. However, defendants seek to avoid the effect of the Colonial Realty case and similar decisions in other circuits, by arguing that the claimed

right of action is unnecessary to fulfill Congress' purposes, because customers have a variety of other remedies. Plaintiff submits that it was Congress' intention to protect investors and that Rules 405 and 408 are clearly designed to do just that; enforcement of Rules 405 and 408 is in accordance with Congress' purposes. Defendants' claim that plaintiff has a "full panoply of common law and statutory remedies". However, if defendants are correct that plaintiff is not entitled to relief under contract and agency theories (although plaintiff disagrees that she is), then plaintiff's only cause of action is under the Federal Securities Laws. Similarly, the fact that Rules 405 and 408 are pursuant to the purpose of the Federal Securities Laws, and may be only enforceable pursuant to said laws, violation of these rules meet Judge Friendly's criteria for stock exchange rules which give rise to an implied Federal cause of action.

Surprisingly, defendants argue that Rule 408 does not give rise to a Federal cause of action, because Rule 408 is designed to prevent "churning". Plaintiff readily concedes that one of the purposes of Rule 408 is to prevent churning. However, obviously this Rule is designed to prevent all abuses

which can accompany the granting of discretionary authority to a stock broker. As plaintiff argued in Point II of her original brief, apparently Rule 408 is designed to assure that a broker with discretionary authority cannot act alone. The Court should bear in mind that ordinarily all investment decisions of a stock broker must be approved by the customer before the transaction can be executed. Since, when there is discretionary authority, the broker does not have to justify his decision to the customer and obtain approval from the customer, Rule 408 assures that another member of the brokerage house will exercise the supervisory role ordinarily played by the customer.

Judge Pierce in his decision held that Count V must be dismissed because it does not allege fraud. At page 52 of their brief, defendants cite several cases in an attempt to support Judge Pierce's holding. However, the Colonial Realty case, Starkman v. Seroussi, 377 F. Supp. 518 (SDNY 1974), and the other cases cited by plaintiff in its brief, do not require an allegation of fraud in order to sustain a complaint based on a violation of supervisory rules.

In an apparent attempt to avoid the line of decisions which have held that a plaintiff need not allege fraud as part

of a cause of action based on violations of stock exchange rules, defendants analyze the facts of some of these cases. However, defendants' attempt has failed. For example, in Starkman v. Seroussi, supra., it is true that the court found that there had been misrepresentation as to compliance with the rules. This fact does not help defendants since, in the case at bar, Dominick's customer agreement promised that all of the rules of the NYSE would be followed; consequently, there was a misrepresentation that the rules would be followed, since they were not in fact followed.

One other example of defendants' attempt to distinguish the cases which support plaintiff's argument, is defendants' discussion of Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith, 410 F. 2d 135 (7th Cir. 1969). Defendants argue that the Buttrey case was partly based on the defendants' knowing violation of Rule 405 of the NYSE (one of the rules violated by Dominick). In the case at bar, it is undisputed that there was a knowing violation. In its papers submitted to the lower court and in its answering brief, defendants have admitted that they did not follow the stock exchange rules and knew that they were not following the rules. However, defendants have argued

that while they did not follow the letter of the stock exchange rules, they were in accordance with the spirit of the rules. As plaintiff proved in its original brief, Dominick did not even act in accordance with the spirit of the rules. In any event, Dominick's violation of the NYSE rules was a knowing violation.

B. Plaintiff is Entitled to Try to Prove that there was a Causal Connection between the Rules' Violations and the Damages sustained by Plaintiff.

The defendants misstate plaintiff's theories in their attempt to prove that plaintiff cannot show causality between the rules' violations and her damages. Defendants are in error.

At page 54 of their answering brief, defendants set up a straw man by arguing that plaintiff must show a connection between defendants' breach and her damages. Plaintiff agrees that causality is an essential element in Count V, and she argues that she can prove causality in this case.

Surprisingly, defendants assert at page 56 of their brief that plaintiff has conceded that she cannot prove a causal connection between the rules' violations and her losses. This assertion is, with all due respects,

ridiculous.

At page 54 of their brief, defendants state that the burden of proving causality is on plaintiff. Plaintiff will not belabor the issue of who has the burden of proving causality, but rather hereby refers the Court to the several cases cited in Point II (A) and (B) of her original brief, which show that when an agent disobeys his principal, the burden shifts to the agent to prove lack of causality. Moreover, notwithstanding which party has the burden of proof, plaintiff is entitled to show that her damages were caused by Dominick's failure to follow the NYSE rules.

Defendants also attempt to argue in their answering brief that plaintiff had an opportunity to show causality at the trial. Plaintiff submits that at the trial, the over-riding issue was "churning"; the court was not concerned, because of its previous dismissal of Count V, with whether Dominick's failure to follow the NYSE rules had caused plaintiff's losses.

At page 57 of their answering brief, defendants quote from Judge Pierce's decision, with respect to the testimony of John J. McDonald. Judge Pierce, in statements

unrelated to his decision in the case, stated that he did not agree with Mr. McDonald's testimony. The Court should note that Judge Pierce did not say that he was giving no weight to Mr. McDonald's testimony. If Mr. McDonald's testimony had been taken as to Count V, his testimony alone, regardless of which party had the burden of proof, may very well have satisfied plaintiff's obligation to prove causality.

Defendants, in a futile attempt to try to convince this Court that plaintiff is not entitled to try to prove causality, argue at pages 58 and 59 of their answering brief, that Mr. Mitchell, an officer of Dominick, now states that he would have approved all of defendant deGive's trades for plaintiff's account. To say Mr. Mitchell was a biased witness would be an understatement. Moreover, plaintiff certainly should have been allowed to argue against Mr. Mitchell's speculation, some seven years after the transactions were executed, as to what he would have done if presented with the orders at that time. Surely, the defendants do not seriously contend that an officer of their company should have the final word as to causality in this case.

Finally, at pages 59 and 60 of their brief, defendants return to their argument that Rule 408 was only designed to prevent "churning". Plaintiff reiterates that while she agrees that one of the reasons for adopting Rule 408 was to prevent "churning", there are several abuses which Rule 408 obviously was designed to counter. Having "two heads" on an account was obviously one of the purposes of Rule 408.

C. Plaintiff is not Estopped from Complaining about Defendants' Rules Violations.

In Point III. (C) of their answering brief, defendants argue that plaintiff ratified the transactions which were executed in violation of the NYSE rules and accordingly, defendants say that plaintiff is estopped from complaining about the rules violations. In making this argument, defendants ignore the requisites of ratification and the nature of discretionary accounts.

As pointed out in plaintiff's original brief, in order to have ratification, a party must have knowledge of the material facts and circumstances relating to the transaction. See, Corrigan v. Bobbs-Merrill Co., 228 N.Y. 58, 70 (1920); First Nat. Bank of Morrisville v. Starke

Design, Inc., 11 A.D. 2d 595, 2-0 N.Y.S. 2d 708, 710
(3rd Dept., 1960).

Defendants attempt to use semantics to convince this Court that plaintiff knew the "material facts" of all of the transactions for her account. Defendants assert that the "material facts" were the name of the stocks purchased and the amount paid for the stocks. Defendants are ignoring the nature of a discretionary account: the customer is relying completely on the broker. Implicit in the customer's reliance is that the broker and the brokerage house in which he works is complying with the exchange rules governing the handling of discretionary accounts. In the case at bar, plaintiff testified at the trial that she knew of the NYSE rules and thought that Dominick was complying with the rules; if plaintiff had known the truth, she would have withdrawn discretionary authority from deGive.

Defendants seem to argue that it would be inequitable to allow plaintiff to prove that the NYSE rules were violated in handling her account, because she raised no objections for many years. However, it is undisputed that plaintiff did not know of the rules violations. The legal effect of plaintiff's silence would have been different if

plaintiff had known of the rules violations and then "sat" on her rights and waited to see how the transactions turned out; but this is not what happened. Actually, it is defendants who should be estopped. They kept from plaintiff the fact that they were not following the NYSE rules, and now seek to avoid their liability because plaintiff did not know, at the time of the transactions involved, that they were not following the NYSE rules.

In conclusion, Judge Pierce erred when he dismissed Count V. Judge Pierce's decision should be reversed and Count V should be remanded for trial so that plaintiff can show that the NYSE rules were violated by Dominick and that she suffered losses as a result of the violations.

POINT III

RATIONALIZATIONS WILL NOT NEGATE THE FACT THAT deGIVE WAS CONSISTENTLY INCONSISTENT

Defendants argue that the existence of deGive's system is proven by the fact that he accumulated mounds of data and charts over the years. However, the mere accumulation of data, charts and other graphical paraphernalia does not, in itself, indicate that a system designed to predict or forecast market movements actually exists. A system must first of all be definable, especially by the one who professes to be its creator, and it must be capable of being consistently applied. Plaintiff proved by deGive's own testimony, that deGive's charts and data were not used by him in a systematic way, and thus, objectively, that he knew he wasn't using a "system".

Whether plaintiff or other investors were defrauded in prior periods by a claimed system when in fact none existed, was not in issue in this litigation. Accordingly, no inference that deGive acted in a good faith belief in the existence of his system in prior years should be drawn by the fact that those years are not included in the complaint.

Defendants attempt to rationalize each of the numerous inconsistencies brought out in plaintiff's brief

by a series of excuses euphemistically labeled the counting problem; a divergence between the hypothetical posed by plaintiff's counsel and the actual evidence; a misnomer; a word game; systematic gymnastics; and finally a typographical error.

Though inconsistencies existed in deGive's testimony which defendants have vainly tried to "cover up", none of those inconsistencies were discussed or even noted in the lower court's opinion, thus leading to the conclusion that these facts were overlooked by the trial court.

Defendants dismissed the first inconsistency as a "counting problem". deGive's testimony is included in the Joint Appendix for the court to review and judge whether there was a "counting problem" or, as the plaintiff suggests, a more fundamental problem - namely that he has no system. If that is true, then his claim that his system guided his actions is sufficient to discredit all of his testimony and his entire defense.

Next the defendants explain away deGive's admission that he did not follow the same system in 1969-70 as he did in prior years by suggesting that coincidentally in every major move made by deGive in 1969-70, 100% of his signals

confirmed each purchase and each sale,* Whereas in every move prior to 1969, 50% of his signals confirm a purchase or a sale. This explanation is ludicrous in light of deGive's testimony and should be dismissed as such.

Defendants argue that the chart offered in plaintiff's brief (P. 47) is misleading because it does not show purchases made in November, 1966. On the contrary, the fact that deGive purchased stocks in November, 1966, supports plaintiff's position. These purchases were made over a period of eleven (11) days, not one or two days as in the complained of period (A. 968). In November, 1966 deGive bought each stock in a cautious manner, not buying all on the same day. For example, 1,000 shares of Fairchild Hiller Corporation were bought on November 4, 1966, another 1,000 shares on November 7, 1966, and another 2,500 shares on November 9, 1966; 900 shares of Raytheon were bought on November 4, 1966, another 1,000 shares on November 9, 1966, and another 500 shares on November 15, 1966. The same pattern was used for the other stocks purchased during this period, including Boeing Co., Magnavox, Texas Gulf Sulphur, Zenith Radio,

*deGive admits that his signals aborted and caused a reversal of his position at least twice during the complained of period. Will defendants have this Court believe that deGive received 100% confirmation for each initial signal and each aborted signal?

TWA and Eastern Airlines. Eleven days of buying would have avoided the February, 1969 loss, because as deGivé claims, on that occasion, his signals aborted within five days; he was in and out, at plaintiff's expense, in less than eleven days.

In response to plaintiff's argument that the trial court made conflicting findings on the question of Dominick's knowledge of its patent violations of the Stock Exchange rules, defendants point to the fact that the trial court found that the officer in charge, Avery Rockefeller, believed Dominick was complying with the rules. However, Rockefeller didn't supervise, but rather delegated the supervisory responsibility over the Van Alen accounts to Thomas Mitchell. Whether or not Rockefeller acted in good faith at the time he turned over responsibility for the accounts to Mitchell, should not have been the determining factor in this litigation. The trial court should have made its determination as to the good faith of the Dominick firm by judging the officers and employees who received the delegation to observe and carry out the rules, namely, deGivé and Mitchell. The intention of those employees must be determined by their conduct. deGivé admittedly broke every rule in handling plaintiff's account. Mitchell's testimony amounts to the same admission. Accordingly, based upon the numerous omissions and violations in the trial record, there is more than sufficient evidence to find that Dominick acted in bad faith with respect to

the Van Alen accounts.

Defendants argue that, at trial, deGive "consistently" refused to characterize his trading for plaintiff in any set category, such as "trader", or "investor", and acted only in Van Alen's best interests. That consistency, defendant argues, shows deGive's good faith and supports the trial Court's reliance on his veracity. This argument simply ignores the issue - deGive's pre-trial testimony shows he did categorize plaintiff and that his testimony, as a whole, is inconsistent and therefore, reasonable men could not accept it for the truth.

POINT IV

DEFENDANTS OFFER NO BASIS IN LAW
OR FACT FOR AWARDING REASONABLE
ATTORNEY'S FEES IN THIS CASE

The defendants admit that there is no statutory basis for their request of reasonable attorney's fees in this case. Furthermore, the defendants have not presented persuasive case authority for extending attorney's fees to cases of this nature.

In fact, plaintiff in its lower court brief in response to this request, pointed out that courts in general have not looked with favor toward granting the judicial relief of attorney's fees for section 10(b)5 violations. (Stratton Group, Ltd. v. Chelsey National Bank, 71-72 CCH Fed. L. Rep. Par. 93, 375 (SDNY 1972))

The Securities Exchange Act of 1934 was designed to protect and encourage investors by allowing them redress of wrongdoing in connection with the purchase and sale of securities. Judge Bonsal's approach to the award of attorney's fees in the Stratton case, supra precludes attorney's fees in the case at bar. In particular, Judge Bonsal stated that:

"It is unusual to award such fees to defendants in actions brought under the Securities Law because plaintiffs,

in bringing such actions, perform a therapeutic service even though it may develop during the course of the litigation that the premises on which they base their actions are without foundation". (Emphasis supplied)

The trial court had before it defendants' memorandum and affidavit in support of their motion for attorney's fees in which they fully stated their unfounded assertions of bad faith. Even though the trial court's opinion dismissed plaintiff's complaint for a variety of reasons, it apparently found defendants' supposition of bad faith completely without merit. Inasmuch as the trial court exercised its reasonable judicial discretion in denying defendants' request, and inasmuch as there has been no evidence presented proving that Judge Pierce's decision was erroneous, the lower court's decision must stand as a matter of law.

Parenthetically, it is interesting to note that defendants wish to penalize the plaintiff with an award of attorney's fees based upon plaintiff's wealth. While the plaintiff, admittedly has not been left impoverished, she is \$600,000 poorer as a result of trades initiated by deGive. Granting attorney's fees would mean that the plaintiff would be required to pay a quarter of a million dollars in fees over and above her own expenses incurred in this lawsuit. This would certainly place an economic hardship on her, and would deter future plaintiffs from bringing claims. The

American Rule that traditionally places the burden of attorney's fees on each party is the only equitable alternative. Accordingly, defendants cross-appeal should be denied.

CONCLUSION

The judgment below in favor of defendants should be reversed, and the order denying reasonable attorney's fees to these defendants should be affirmed.

Dated: New York, N. Y.

June 10, 1977

Respectfully submitted,

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2 Copies Received

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